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Nos. 86-152, 86-153 and 86-154

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

INVESTMENT COMPANY INSTITUTE,
Petitioner,

v.

ROBERT L. CLARKE, ET AL.,
Respondents.

REPLY BRIEF IN SUPPORT OF PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURTS OF APPEALS FOR THE DISTRICT OF COLUMBIA, SECOND AND NINTH CIRCUITS

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The lower courts here proclaimed themselves without power to reverse, and therefore upheld, concededly "superficial" administrative rulings that "come perilously close to rejecting the division between commercial banking and investment banking that Congress sought to mandate in Glass-Steagall" (No. 86-153, Pet. 9). One court did so because the rulings were presented in written documents and because the documents purported to apply, "however inadequately," the relevant "mode of analysis" (No. 86-153, Pet. 22). Another court deferred because, even though Congress has refused to amend the Glass-Steagall Act to authorize the precise bank IRA mutual funds at issue, Congress could repair the damage "if it finds itself in disagreement with the actions of the Comptroller or the courts" (No. 86-152, Pet. 23). By defending the notion that the doctrine of judicial deference renders federal courts helpless to prevent administrative "interpretive" dismantling of fundamental federal statutes, even when undertaken in contravention of longstanding policy judgments deliberately made and repeatedly reaffirmed by Congress, Respondents' briefs in opposition confirm and underscore that the Petitions for Certiorari should be granted.

First. The rulings at issue undermine the fundamental legislative purpose of the Glass-Steagall Act by exposing banks to all

the potential conflicts of interest, financial dangers, and other abuses that Congress sought to eliminate by excluding banks from the mutual fund business. *Investment Company Institute* v. *Camp*, 401 U.S. 617 (1971) (*"Camp"*). Although Respondents' briefs assert that these dangers are not present here (Gov't Br. 16; Banks Br. 18), *the rulings* at issue *concede* their existence, advocating ad-hoc administrative regulation of bank mutual funds as the proposed means to reduce (albeit not eliminate) the dangers Congress feared.[1]

The problem with this solution, however, is that both Congress and this Court repeatedly have rejected it as an inadequate substitute for the structural statutory prohibitions *Congress* deemed necessary to achieve its policy goals. *Securities Industry Association* v. *Board of Governors*, 468 U.S. 134, 153 (1984) (*"Becker"*). As Judge Schwarzer and Judge Coughenour declared below, the Comptroller's rulings "simply disagree with Congressional determinations, enumerated in *Camp* and *Becker*, regarding the potential dangers of commercial bank entry into the field of investment banking" (No. 86-153, Pet. App. 5a, 22a).[2]

Second. Simply ignoring this Court's holding in *Camp*, and their own admissions (No. 86-152, Pet. 5,7; No. 86-153, Pet. 5) and stipulations (No. 86-154, Pet. App. 75a-76a) that the Respondent banks created their IRA funds solely to engage in the mutual fund business, Respondents limit their substantive defense of the rulings to arguing irrelevant issues. It simply is of no moment that Congress may have permitted banks to structure

1. The rulings expressly state that the Comptroller's regulatory authority can only "substantially control," but not preclude, "the types of hazards identified in ICI v. Camp" (No. 86-154, Pet. App. 30a). The rulings also concede that administrative regulation can only "limit the bank's ability" to misuse its credit facilities (*id.* at 26a), "reduce the danger of promotional abuses" (*id.* at 28a) and render "unlikely" or "implausible" at best the widespread occurrence of the other specific dangers which prompted Congress to enact the statutory bar (*id.* at 42a).

2. None of the Respondents confronts the stark reality of this Court's decision in *Becker*. Indeed, the brief of the Federal Respondent off-handedly refers to *Becker* once (Gov't Br. 12 n. 7) while Respondent banks make no mention of *Becker* at all.

IRA accounts in either "trust" or "custodial" form; the dispositive point is that, because the Act's flat prohibitions contain no "trust" exception, they forbid banks to underwrite mutual fund securities to IRA "trust" customers, be they "bona-fide" (Gov't Br. 13-14) or otherwise, just as firmly as Respondents concede the prohibitions to forbid bank underwriting of such securities to IRA (and non-IRA) "agency" customers (No. 86-152, Pet. 12-15).

Similarly, the rulings under review have nothing whatsoever to do with the traditional bank fiduciary service of "commingling" trust assets in common trust funds.[3] Although the Act has been interpreted to permit banks to "pool trust assets" solely as an "aid to the administration" of pre-existing individual trusts, 26 Fed. Res. Bull. 393 (1940), *cited with approval in Camp*, 401 U.S. at 621, 638 n. 37, that traditional administrative "commingling" is *not* the activity at issue here.[4] Rather, the Comptroller has run roughshod over the Act and this Court's decision in *Camp* by authorizing the nation's 33,000 depository institutions to create

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3. Confirmation of this fact is provided by the well-established principle of fiduciary law requiring common trust funds to be maintained under the "exclusive management" of the sponsoring bank. *See* Reg. F, 2 Fed. Reg. 2976 (1937); 12 C.F.R. § 9.18(b)(12). The rulings under review, however, for the first time in the history of bank common trust funds, waive the need for the banks to comply with this requirement in order to permit the banks to vest exclusive management of their IRA funds, as required by the terms of the Investment Company Act of 1940, 15 U.S.C. § 80a-15, in an independent Board of Directors. Notably, Respondents do not even attempt to rebut Judge Schwarzer's holding (No. 86-153, Pet. App. 19a) that bank operation of mutual funds cannot possibly constitute a bona-fide bank fiduciary service since the sponsoring banks are conceded to have transferred their fiduciary responsibilities to outsiders over whom they exercise no power or control.

4. Further confirmation is provided by the federal securities laws, which contain express registration exemptions for bank common trust funds (and interests therein) which are used for this intended fiduciary purpose. It is undisputed that these exemptions were unavailable to the bank IRA mutual funds at issue here (No. 86-152, Pet. 13 n. 18). Although Respondent banks respond that the securities laws are irrelevant in construing the Glass-Steagall Act because the securities laws "were enacted for purposes quite distinct from the purposes of the Glass-Steagall Act" (Banks Br. 13-14), this Court has held to the contrary. *Becker*, 468 U.S. at 150.

"common trust funds," to register those funds as mutual funds with the SEC, to register the shares of those mutual funds as "securities" with the SEC, and to underwrite and distribute those securities to the 111 million members of the nation's work force as investments.[5]

It is this "pioneering" attempt[6] to transform a purely administrative aid to the performance of a bank's bona-fide fiduciary duties as trustee into a vehicle enabling banks to underwrite securities by engaging in the mutual fund business that the Comptroller has sanctioned in these cases. And, it is this "pioneering" attempt to expand the traditional fiduciary role of a bank as trustee to encompass the Congressionally-forbidden role of "market[er]" and "promoter" of securities, *Becker*, 468 U.S. at 154-160, that transgresses the flat prohibitions of the Glass-Steagall Act. For, as this Court held in *Camp*, and as the banking agencies consistently held before the rulings under review, the Act's securities underwriting bar by its terms prohibits banks from "embark[ing] upon what would be in effect the sale of participations in a Common Trust Fund to the public as investments." *Camp*, 401 U.S. at 621, 638 n. 37 (quoting 26 Fed. Res. Bull. 393 (1940)).[7]

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5. Respondents' efforts to pretend that the rulings authorize nothing but traditional bank activity (Gov't Br. 13; Banks Br. 9-13) are belied by the American Bankers Association, which has publicly admitted that the rulings at issue represent "the first time" since Congress enacted the Glass-Steagall Act in 1933 that a bank has been allowed to underwrite securities by operating "a common trust fund that has been registered as a mutual fund with the SEC." *Court of Appeals Rules In Favor of Citibank Forming Mutual Fund For IRAs*, Securities Week, May 26, 1986 at 9.

6. *Fund News: Banks, Nukes, Fewer Meetings*, Wall Street Journal, May 28, 1986 at 37 (statement of CBT President James F. McNally).

7. Respondents' insistence that adherence to the Glass-Steagall Act's flat prohibitions would prohibit "all commingling of trust funds by national banks" is misplaced. The Act does not prohibit national banks from having "any connection with" securities; it prohibits banks from engaging "in the business" of "issuing, underwriting, selling, or distributing" securities to the public. A bank does not engage in these prohibited activities when it simply commingles the assets of pre-existing trusts in a common trust fund.

Third. While purporting to support all three contrary appellate decisions below, Respondents do not even attempt to reconcile the various opinions with each other or with the administrative rulings they purport to affirm (Gov't Br. 1-17; Banks Br. 1-20). This omission is hardly surprising. The courts below accorded virtual *"carte blanche"* deference, *Bowen* v. *American Hospital Association,* 106 S.Ct. 2101, 2122 (1986), to the Comptroller's conclusions, while ignoring the shifting and inconsistent rationales proffered by the Comptroller and his litigation counsel (No. 86-152, Pet. 22-23 & nn. 34-35) in an effort to justify the decision to permit banks to enter the mutual fund business. And, to the extent the courts addressed the merits themselves, they not only criticized or abandoned the Comptroller's decisions (No. 86-152, Pet. 8 n. 9; No. 86-153, Pet. 9-10), but adopted sharply divergent bases for their holdings (No. 86-152, Pet. 10-11), leaving the law in a state of internal contradiction and disarray. The resulting chaos is amply demonstrated by the fact that Respondents' briefs bear little resemblance to any administrative or judicial opinion under review and by the irony that the rulings and briefs rely mightily on ERISA (Gov't Br. 12-13; Banks Br. 12-15), while both the District of Columbia and Ninth Circuits flatly rejected the relevance of ERISA to the questions presented here.[8] The need to resolve this chaos alone plainly "warrant[s]" this Court's review (Gov't Br. 17).

Fourth. In an effort to distance these cases from the documented (and undefended) campaign by the Comptroller and other federal banking regulators to rewrite and dismember the Act's prohibitions through administrative "interpretation," the Federal Respondent claims that the numerous other administrative proceedings and revisionist rulings cited by the Institute "have nothing to do with the resolution of the Glass-Steagall issue in this case" (Gov't Br. 15-16 n. 11). Actually, the Comptroller

8. "We also agree with the District of Columbia Circuit that [ERISA] and its legislative history are not relevant in the decision before us" (No. 86-153, Pet. App. 4a n.2; *see* No. 86-152, Pet. App. 14a).

himself specifically has relied upon the appellate opinions under review as support for his unprecedented decision to authorize the nation's banking industry to underwrite bonds[9]—a ruling that Congressional leaders have condemned as part of the Comptroller's ongoing "regulatory assault on the barrier between commercial and investment banking erected by [Congress in] the Glass-Steagall Act."[10] Any possible doubts about the broad impact and nationwide importance of the rulings at issue or of the unbounded and ever-expanding exception they have engrafted upon the Act's unqualified securities underwriting bar already have been dispelled.

Fifth. Respondents do not dispute (Gov't Br. 1-17; Banks Br. 1-20) the far-reaching dangers posed by the decisions below to the carefully balanced and intertwined statutory scheme Congress enacted in 1933 to govern the banking and securities underwriting industries. Nor do they offer any explanation or defense for the radical surgery the SEC already has found it necessary to perform upon its own organic statutes in order to redress the statutory imbalance created by the banking agencies' unilateral repeal of the Glass-Steagall Act's prohibitions (No. 86-152, Pet. 19-20 n. 30).[11] This silence itself confirms that action by this Court is essential, not only to confirm the continuing vitality of the Act's flat prohibitions, but also forcefully to reiterate that, if existing banking statutes are not serving the public interest, "that

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9. Letter dated June 18, 1986 from Robert L. Clarke, Comptroller of the Currency, to Senator Alfonse M. D'Amato, Chairman, Senate Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs.

10. Letter dated June 3, 1986 from Senator Alfonse M. D'Amato, Chairman, Senate Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs to Robert L. Clarke, Comptroller of the Currency.

11. Indeed, the General Counsel of the SEC just recently announced that further revisionist action may be necessary now that "banks and securities firms offer functionally similar products—bank sponsored collective investment funds, on the one hand, and mutual funds on the other—under radically different regulatory regimes." *SEC Staffer Eyes Bank Securities Activities In Commercial Paper & Pooled IRA Funds*, 20 Banking Reg. 3 (May 19, 1986).

is a problem for Congress, and not the [banking agencies] or the courts, to address." *Board of Governors* v. *Dimension Financial Corp.*, 106 S. Ct. 681, 689 (1986).

CONCLUSION

The opinions below, if allowed to stand, will almost certainly signal to lower courts and federal regulators an abdication of the judiciary's duty to interpret faithfully the statutes enacted by Congress and to prevent the administrative dismantling of the fundamental and longstanding expression of national banking policy embodied in the Glass-Steagall Act. Absent action by this Court, bank regulators are likely to continue, as here, to authorize activities in their view of the public interest that Congress deliberately has prohibited (No. 86-152, Pet. 16 & n. 24) and to assume policy decisions of enormous economic significance that properly may be made only by Congress. This Court's intervention thus is critical to reaffirm that "there are limits . . . on how far an agency may go in its interpretive role," and that deference cannot substitute for the judicial "obligation to honor the clear meaning of a statute, as revealed by its language, history and purpose." *International Brotherhood of Teamsters* v. *Daniel*, 439 U.S. 551, 566 & n.20 (1979).

For the reasons set forth above and in the Petitions themselves, the Petitions for Certiorari should be granted.

Respectfully submitted,

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